

McGladrey & Pullen

Certified Public Accountants

To the Honorable Mayor and
Members of the City Council
City of Glendale, CA

In connection with our audit of the basic financial statements of the City of Glendale, California (the City) as of and for the year ended June 30, 2009, we identified deficiencies in internal control over financial reporting (control deficiencies).

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect financial statement misstatements on a timely basis. A deficiency in design exists when a control necessary to meet the control objective is missing, or when an existing control is not properly designed so that even if the control operates as designed, the control objective is not always met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affect the entity's ability to authorize, initiate, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

We did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies, as defined above.

Other Control Deficiencies

Following are descriptions of other identified control deficiencies that we determined did not constitute significant deficiencies or material weaknesses:

Timely Departmental Invoice Submission to Finance

Condition: During our search for unrecorded liabilities, we noted two exceptions in which invoices processed by the Finance Department several months after fiscal year-end relating to construction services performed prior to the fiscal year-end date were not recorded as payables in the proper period. Conversely, we noted a payable related to insurance for the subsequent period that was improperly included in payables as of the fiscal year-end date. It appears the invoices and other supporting documentation needed by the Finance Department to properly process these payables are maintained with the respective City department and are not timely submitted to the Finance Department. The proper recording of liabilities at period-end is fundamental in producing accurate and reliable financial statements and matching revenues with expenses.

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Recommendation: We recommend all City departments review and strengthen their policies and procedures with respect to processing disbursements so that invoices and other supporting documentation is timely submitted to the Finance Department for proper payment and timely recording into the general ledger. The following procedures should be considered when reviewing the adequacy of the department's policies:

- Departmental personnel should log all invoices received subsequent to June 30 and review/process those invoices timely for proper recording in the correct period.
- All unpaid invoices, open purchase orders and unmatched receivers should be scanned for items or services received before year-end for inclusion on the add-on listing, along with other known liabilities.
- Departmental administration should review the open accounts payable log at least monthly subsequent to June 30 to ensure proper recording of the invoice.

Deferred Revenue

Condition: The City overaccrued revenue for the Urban Area Security Initiative (UASI) grant at the governmental fund level for the fiscal year ended June 30, 2009 by approximately \$1.2 million. The City's policy with respect to accounting for intergovernmental revenue is to recognize intergovernmental revenue in the period it is susceptible to accrual (when it is both measurable and available to finance the expenditures of the fiscal period). Intergovernmental revenue is considered available if it is expected to be collected within 120 days of fiscal year-end and all eligibility requirements are met. Not all revenue earned by the City as of June 30, 2009 was received as of October 31, 2009 to comply with the City's policy. As a result, the City would have recognized deferred revenue at the fund level of \$1.2 million.

Recommendations: We recommend the City comply with its revenue recognition policies to ensure intergovernmental revenue is recognized in the proper period consistent with accounting principles generally accepted in the United States of America.

Comments and Suggestions

In addition to the above internal control matters, the following are comments and suggestions with respect to matters that came to our attention in connection with our audit of the basic financial statements of the City for the year ended June 30, 2009. These items are offered as constructive suggestions to be considered as part of the ongoing process of modifying and improving the City's practices and procedures:

Deficits in Internal Service Funds

Condition: The City has the following four internal service funds with fund deficits as of June 30, 2009: (1) Liability Insurance Fund with a fund deficit of approximately \$10,070,000; (2) Compensation Insurance Fund with a fund deficit of approximately \$9,419,000; (3) Employee Benefits Fund with a fund deficit of approximately \$7,958,000 and (4) Retiree Health Savings Plan Benefits Fund with a fund deficit of approximately \$7,342,000. By definition, an internal service fund is operated on a cost-reimbursement basis. For an internal service fund to operate on a cost-reimbursement basis, its charges to other funds should result in revenues and expenses that are approximately equal over time, even though it may periodically report annual increases or decreases in net assets. Because the intent of internal service funds is to facilitate cost allocation, the accumulation of net asset surpluses or deficits over time generally indicates that service is no longer being made on a cost-reimbursement basis.

Recommendation: We recommend the City reassess the cost allocation methodology of these four respective internal service funds so that the user funds or departments are charged the appropriate amount that covers the cost of providing the respective services.

Debt Covenants

Condition: The City has various bond indentures that contain various restrictive and financial covenants. Failure to comply with the restrictive covenants or failure to meet the financial covenants could result in the debt becoming due and payable. We found no formal monitoring of these covenants was being performed during the year.

Recommendation: We recommend a checklist be developed containing all restrictive covenants. Restrictive covenants should be reviewed periodically for compliance and this review should be documented on the checklist. We also recommend formal calculations of any required financial covenants, such as debt service coverage, be completed monthly and reviewed by management.

Capital Asset Impairment Policy

Condition: The City does not have a formal policy in place to determine capital asset impairment. Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, establishes accounting and financial reporting standards for impairment of capital assets. The City's capital assets include property, plant, equipment and infrastructure assets. A capital asset is considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Common indicators of impairment include evidence of physical damage where restoration efforts are needed to restore service utility, enactment or approval of laws or regulations setting standards that the capital asset would not be able to meet, technological development or evidence of obsolescence, a change in the manner or expected duration of use of a capital asset or construction stoppage. This Statement also requires governments to report the effects of capital asset impairment in their financial statements when they occur, rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset and to account for insurance recoveries in the same manner.

Recommendation: The City should establish formal written procedures for the process of identifying, capturing and recording the required capital asset impairment information. These procedures should (a) document how potential impairments will be identified by individual departments with custodial responsibility for capital assets, (b) establish methods for testing for impairment, (c) assign responsibility for performing the impairment testing and (d) establish a timeline and process for communicating the capital asset impairment information to the Finance Department for recording in the City's financial records.

This communication is intended solely for the information and use of the audit committee, Mayor, City Council and management of the City. However, this report is a matter of public record and its distribution is not limited.

McGladrey & Pullen, LLP

Pasadena, CA
November 24, 2009